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No. 173

In the Supreme Court of the United States

October Term, 1945

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner

v.

William A. Sawyer

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

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No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, Petitioner

v.

SAMUEL A. SALVAGE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Second Circuit entered in the above-entitled cause on March 25, 1935, reversing the decision of the Board of Tax Appeals in part.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 49–56) is unreported. The opinion of the Circuit Court of Appeals (R. 135) is reported in 76 F. (2d) 112.

JURISDICTION

The judgment of the Circuit Court of Appeals, reversing the decision of the Board of Tax Appeals in part and affirming it in part, was entered on March 25, 1935. (R. 140.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

On December 30, 1922, the taxpayer exchanged 1,500 shares of stock of the Viscose Company, acquired the same day, together with 25 other shares purchased in 1916, for 6,100 shares of preferred stock and 7,625 shares of common stock of the American Viscose Corporation pursuant to a nontaxable exchange. The preferred stock was redeemed in 1929. The question is—

Whether the taxpayer is estopped to claim that the difference between the market value of the 1,500 shares as of December 30, 1922, and their cost to him constituted taxable income to him for 1922 and hence that the fair market value of these shares and not their cost [1] is the basis to be used in meas-

[1] Either the cost or the market value of the old stock will represent the total basis for measuring gain or loss from the disposition of the aggregate shares of new common and preferred stock. The court below sustained the Government's position that the basis used would have to be apportioned between the new common and new preferred stock according to their respective market values at the time of

uring the gain from the disposition of the shares in 1929, no income from the transaction having been reported in 1922.

STATUTES INVOLVED

The statutes involved are set forth in the Appendix, *infra,* pp. 17–18.

STATEMENT

The following facts are taken from the stipulation of facts, the memorandum opinion of the Board of Tax Appeals, and the deposition of the taxpayer:

In 1929 the taxpayer received $671,000 from the redemption of 6,100 shares of preferred stock of the American Viscose Corporation. (R. 49, 51.) This stock had been acquired December 30, 1922, together with 7,625 shares of common stock, in exchange for stock of the Viscose Company, under the following circumstances:

In December, 1922, the taxpayer, an officer and employee of the Viscose Company, held 25 shares of common stock of that company, which he had purchased at $166.66⅔ a share. (R. 49.) At that time the Viscose Company increased its capital stock by 4,000 shares and permitted him to purchase 1,500 shares at $100 a share. (R. 83–91.)

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the exchange and approved the method of apportionment. See Section 113 (a) (6) of the Revenue Act of 1928; Article 1567 of Regulations 62, and I. T. 2335, VI–1 Cumulative Bulletin 18.

This sale was made pursuant to a contract of December 30, 1922, in consideration of his agreement not to engage in a competing business without the consent of the company. The stock was subject to repurchase in part. (R. 28–30.)[2]

On the same date that this agreement was made with the Viscose Company (hereinafter called the old company), the American Viscose Corporation (hereinafter called the new company) was incorporated in Delaware and issued 4 shares of its preferred and 5 shares of its common stock in exchange for each share of common stock of the old company. (R. 24–25.)

The taxpayer, under a separate agreement, was given the right to exchange his 1,525 shares, which had cost him an aggregate sum of $154,166.66. (R. 51, 103, 104.)

In his 1929 return, the taxpayer reported as a gain from the redemption of the preferred stock, the difference between $671,000 and $154,166.66, the entire cost of all the shares of the old company. (R. 51.)

The Commissioner determined a deficiency of $12,005.38 by determining that 37.778 percent of the cost basis of the old stock should be apportioned to the new preferred stock and 62.222 percent of such basis to the new common stock. This apportionment was made according to the relative market values of the new preferred and new common stock at the time of the exchange. (R. 26, 27, 39,

[2] The option was never exercised. (R. 51.)

49, 51–52.) This apportionment gave a basis of $58,123.47 for the preferred stock and was used by the Commissioner in measuring the gain. (R. 26.)

Before the Board the taxpayer claimed that it was not practicable to determine the market value of the preferred and common stock as of December 30, 1922, that no apportionment of the cost basis of the old stock between the new preferred and new common stock should be made, and that the entire cost should be used as a basis. In addition, he claimed a refund of $63,750, based on the contention that the proper basis of the stock received in exchange for the 1,500 old shares was not the cost of such 1,500 shares ($100 per share), but their fair market value as of the time of their acquisition ($1,164.70 per share) on the theory that the difference represented compensation for services. (R. 4–5, 52–53.)

The Board determined that the difference was not compensation for services and that neither the taxpayer nor the old company had so treated it for tax purposes. (R. 54–55.) It held that the basis was the cost of the old stock and that the basis was properly apportioned by the Commissioner. (R. 55–56.)

The court below held that the difference between the cost and market value of the old stock was not compensation for services in 1922, but that it was income realized at that time from a promise not to engage in a competing business and that the taxpayer was not estopped to present this claim. It,

therefore, held that the basis of 1,500 shares was market value and not cost, but that only two-sevenths of those shares had a market value of $1,164.70 and the remaining five-sevenths a market value of $100 a share, due to the option for repurchase by the corporation, so that the aggregate market value was $606,300.

The court further held that the basis of the old shares ($4,166.66 for the 25 shares and $606,300 for the 1,500 shares) could be apportioned according to the method used by the Commissioner, the use of which would apportion $230,662.09 to the preferred stock. Since this was in excess of the basis originally reported by the taxpayer, the court held that there was no deficiency and directed the Board to determine the amount of refund due.

SPECIFICATION OF ERROR TO BE URGED

The Commissioner submits that the Circuit Court of Appeals erred:

In failing to hold that the taxpayer was estopped to claim that the basis for measuring the gain from the redemption of his new stock in 1929 was the fair market value of the old stock when acquired in 1922, by his failure to report the difference between the cost and fair market value as income for 1922.

REASONS FOR GRANTING THE WRIT

The court below held that the difference between the market value of the stock of the old company and its cost to the taxpayer under the contract of

December 30, 1922, constituted taxable income to the taxpayer arising from an agreement not to engage in a competing business. On that theory it held that the basis of the old stock to be apportioned between the two kinds of new stock received in the non-taxable exchange of December 30, 1922,[3] in measuring the gain from the new preferred stock, was not the cost of the old stock, but its fair market value at the time of the exchange.

The court below thus decided the case on a theory not considered by the Board or suggested by the taxpayer, and rejected the contention of the Government that the taxpayer was estopped to claim that he had realized income in 1922 equal to the difference between the market value and the cost of the old stock and that the market value of the old stock was the basis to be used in measuring the gain from the disposition of the new.[4]

The taxpayer filed an income-tax return for 1922 in which he failed to report any income from this purchase of the stock at less than its market value or to disclose the transaction (R. 74, 75–6, 83). The assumption of the court below that the taxpayer might have disclosed the transaction in his return for 1922 even though he had not reported any income from it is clearly contrary to

[3] The total shares of new common and new preferred stock have the same basis as the old stock, since the exchange was a nontaxable exchange. Section 113 (a) (6) of the Revenue Act of 1928.

[4] This contention was made in the reargument ordered by the court on its new theory.

the record. The taxpayer admitted in his deposition that he had not reported any income from it, stated that he had not done so because he did not see how he could arrive at it, and admitted that he had not put anything in his return for 1922 or made any statement to the effect that he had received compensation the amount of which could not be liquidated or estimated (R. 75–76). He also admitted that he reported nothing but cash received in any year (R. 78), and that when he filed his 1922 return he did not consider that he had received any property of value which was not included (R. 83). The Commissioner relied upon the taxpayer's sworn return as a disclosure of his correct taxable income for the year 1922 and the time for assessing an additional tax for that year expired four years from the date of filing the return, which was required to be filed on or before March 15, 1923. See Section 250 (d) of Revenue Act of 1921 and Section 277 (a) of Revenue Act of 1926.

The case is one in which the taxpayer is claiming now that income was derived from the receipt of the stock in 1922 and a new basis established for measuring gain from the disposition of the stock in 1929, after he had previously taken the contrary position and induced the Government to rely upon it to the Government's detriment. There was thus a failure to disclose a transaction which the taxpayer was required to disclose in its sworn return, a reliance upon the taxpayer's act by the Govern-

ment, and a subsequent reversal of position by the taxpayer to the Government's detriment. The existence of these elements is all that is required to establish equitable estoppel or estoppel *in pais*. *Stone* v. *Bank of Commerce*, 174 U. S. 412; *Kirk* v. *Hamilton*, 102 U. S. 68; *Dickerson* v. *Colgrove*, 100 U. S. 578; *Oklahoma* v. *Texas*, 268 U. S. 252; *Nelson* v. *Chicago Mill & Lumber Corp.*, 76 F. (2d) 17 (C. C. A. 8th); *Stearns Co.* v. *United States*, 291 U. S. 54.

In holding that there was no estoppel in this case, the decision of the court below is directly opposed to that of the Circuit Court of Appeals for the First Circuit in *Crane* v. *Commissioner*, 68 F. (2d) 640, the decision of the Circuit Court of Appeals for the Tenth Circuit in *Bothwell* v. *Commissioner*, decided April 10, 1935, not officially reported but found in 1935 C. C. H., Vol. 3, par. 9302, and the decision of the Circuit Court of Appeals for the Fifth Circuit in *Edward G. Swartz, Inc.* v. *Commissioner*, 69 F. (2d) 633.

In the *Crane* case, the taxpayer claimed that in computing the gain from the sale of certain real estate in 1927, there should be added to the March 1, 1913, value the value of improvements made by the lessee, even though the value of those improvements had not been reported as income for earlier years, against which the statute of limitations had run. The court applied the doctrine of estoppel.

In *Bothwell* v. *Commissioner, supra,* the taxpayer, an employee of a corporation, acquired an option to purchase certain shares of its stock and exercised it in 1927, when the market value was in excess of the option price. He sold the stock in 1928 and in his amended petition before the Board, which was filed after the statute of limitations had run against 1927, claimed that the basis for measuring the gain was the market value of the stock in 1927 and not its cost. The court rejected that contention, holding that if the difference between the option price and the market value of the stock were income for 1927, the taxpayer was required to report it, that his failure to report it was in effect a declaration that no such income had been received, and that by his wrongful acts and omissions he was precluded from asserting otherwise.

In the *Swartz* case, *supra,* a timber owner, Swartz, had assigned a profit-sharing timber contract with one corporation to another corporation, of which he was sole stockholder. The taxpayer corporation reported the income each year for a number of years as assignee and had based depletion on cost of timber or its fair market value as of March 1, 1913, but in 1926, for the purpose of eliminating all tax liability for that year, adopted the theory that Swartz was still taxable upon the income and that in any event there was a taxable exchange of timber for a contract in 1919 from which a profit was realized, though not reported, and that the value of the contract became the basis

for depletion. The court held that estoppel barred both contentions.

We believe that the three cases just cited are indistinguishable on the facts from the present case and hence that there is a direct conflict.

The court below cited its own decision in *Helvering* v. *Brooklyn City R. Co.*, 72 F. (2d) 274, as authority for its position. The question in that case was whether the taxpayer was estopped to contend that a return for the calendar year 1921 should have been a return for a fiscal year. The court there held there was no estoppel. But in that case a cursory examination of the taxpayer's books would have disclosed the fact that they were kept on a fiscal year basis and the statute required that the returns must be made on the same basis as the books. It was not shown that the tax for earlier years would have been greater if the returns had been properly filed, and in the only year in which it might have been said that the Government was injured, it was not shown whether the question was raised so late as to prevent a correction.

The same court in the earlier case of *Askin & Marine Co.* v. *Commissioner*, 66 F. (2d) 776, held that where a taxpayer had charged off certain debts as worthless in one year and subsequently collected them, he would not be heard to say that they were not worthless in that year for the purpose of eliminating from his return the income represented by the collections in the later year.

In the case of *United States* v. *S. F. Scott & Sons,* 69 F. (2d) 728 (C. C. A. 1st), the same court that decided the *Crane* case determined that there was no estoppel, for the reason that the error originated in the misconstruction of the law by the Commissioner and if there had been any misleading, the Government rather than the taxpayer had been guilty of it.

In addition to the *Crane, Bothwell;* and *Swartz* cases, which are directly opposed to the decision in this case, there is a long list of cases in which the courts have applied the doctrine of estoppel to comparable situations.

In *Stearns Co.* v. *United States,* 291 U. S. 54, this Court held that where a taxpayer, in filing a claim for overpayment of income taxes for several years, asked that the amount overpaid be credited against an unpaid tax and the Commissioner after considering the claim so does, the taxpayer is estopped from claiming the amount is still due him upon the ground that the collection of the unpaid tax had in the meantime been barred by limitation. The instant case presents the question whether a taxpayer who has treated a contract in one way for tax purposes may thereafter treat it in another way, with the result that, if his theory be accepted, certain taxable income will escape tax altogether. This type of question frequently arises; it is therefore desirable to have the Court determine whether the principle applied in the *Stearns* case applies likewise to the situation herein.

Other cases applying the principle of estoppel where the Government would be injured through the taxpayer's change of position are *Giant Furniture Co.* v. *United States,* 9 F. Supp. 585 (C. Cls.); *Adler* v. *Commissioner,* decided by the Circuit Court of Appeals for the Fifth Circuit on May 22, 1935, not yet officially reported but found in 1935 C. C. H., Vol. 3, par. 9397; *Naumkeag Steam Cotton Co.* v. *United States,* 2 F. Supp. 126 (C. Cls.), certiorari denied, 289 U. S. 749; *Commissioner* v. *Liberty Bank & Trust Co.,* 59 F. (2d) 320 (C. C. A. 6th); *Continental Products Co.* v. *Commissioner,* 66 F. (2d) 434 (C. C. A. 1st); *Mahoning Investment Co.* v. *United States,* 3 F. Supp. 622 (C. Cls.), certiorari denied, 291 U. S. 675; *Matern* v. *Commissioner,* 61 F. (2d) 663 (C. C. A. 9th).

Finally, we call the attention of the Court to the fact that the failure of the court below to apply the doctrine of estoppel [5] will not only eliminate the

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[5] In his petition the taxpayer made no contention that any part of the difference between the market value of the 1,500 shares as of December 30, 1922, and their cost to him, constituted a payment for his agreement not to compete and hence constituted income based thereon in 1922. The answer of the respondent, therefore, did not contain a plea of estoppel. The issue was first raised by the Circuit Court of Appeals when it asked for a reargument on the point. No question was raised either by the taxpayer or by the court below as to the failure of the pleadings to present the issue or the plea of estoppel. Even if it had been, however, we believe the failure to plead estoppel would be excused because the issue was not raised in the petition, and hence there was no reason or opportunity to plead estoppel. *United States Fidelity & Guaranty Co.* v. *Wilson,* 41 F. (2d) 319 (C. C. A. 8th); *Herbert* v. *Champagne,* 144 La. 659; *New*

deficiency proposed by the Commissioner for 1929, but will result in the allowance of a refund. We believe that that fact furnishes a circumstance

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York Life Ins. Co. v. *Rees*, 19 F. (2d) 781 (C. C. A. 8th); *Paine* v. *Strom*, 51 Idaho 532. Moreover, at common law it was not necessary to plead estoppel *in pais*. *Feinberg* v. *Allen*, 208 N. Y. 215; *Boone* v. *Citizens Bank & Trust Co.*, 154 Tenn. 241; *Shelton* v. *Southern Ry. Co.*, 255 Fed. 182 (E. Tenn.); 21 C. J. 1241; Bigelow on Estoppel, 5th Ed., p. 699. That is still the law in some jurisdictions (see *Shutter Bar Co.* v. *Zimmerman*, 110 Md. 313; *Feinberg* v. *Allen*, *supra; Intertype Corp.* v. *Pulver*, 2 F. Supp. 4 (S. D. Fla.), affirmed, 65 F. (2d) 419 (C. C. A. 5th), certiorari denied, 290 U. S. 660; *Bemis* v. *Pacific Coast Casualty Co.*, 125 Minn. 54), while in others it must be pleaded if there is opportunity. *Laughinghouse* v. *Insurance Co.*, 200 N. C. 434; *Hall & Farley* v. *Henderson*, 126 Ala. 449; *Mabury* v. *Louisville & J. Ferry Co.*, 60 Fed. 645 (C. C. A. 7th); *Promis* v. *Duke*, 208 Cal. 420; *Walker* v. *Fireman's Fund Ins. Co.*, 114 Ore. 545. Each State has its own rule, influenced to a considerable extent by its statutes concerning pleading. Section 907 (a) of the Revenue Act of 1924 as amended by Section 1000 of the Revenue Act of 1926 and by Section 601 of the Revenue Act of 1928 provides that the proceedings of the Board and its divisions shall be conducted in accordance with such rules of practice and procedure (other than rules of evidence) as the Board may prescribe and in accordance with the rules of evidence applicable in courts of equity in the District of Columbia. The Board rules do not contain any reference to estoppel. The only rule at all pertinent is Rule 14, which requires the Commissioner to file an answer which shall contain "a specific admission or denial of each material allegation of fact contained in the petition and a statement of any facts upon which the Commission relies for defense or for affirmative relief or to sustain any issue raised in the petition in respect of which issue the burden of proof is, by statute, placed on the Commissioner." In *Board of Tax Appeals* v. *United States ex rel. Shults Bread Co.* (App. D. C.), 37 F.

which should have been but was not considered by the court below, for equitable principles are given particular application in the case of a repayment. See *Newaygo Portland Cement Co.* v. *Helvering,* decided by the Court of Appeals for the District of Columbia on April 15, 1935, not yet officially reported but found in 1935 C. C. H., Vol. 3, par. 9320.

CONCLUSION

The decision is in conflict with decisions of other Circuit Courts of Appeals. The question of the application of estoppel is involved in a number of cases now pending before the Bureau of Internal Revenue and the courts, and will arise in subsequent cases. We respectfully submit that this petition should be granted.

STANLEY REED,
Solicitor General.

JUNE 1935.

(2d) 442, certiorari denied, 281 U. S. 731, the Court of Appeals for the District of Columbia held that mandamus should not issue to compel the Board to enter judgment for the taxpayer by default, when the Commissioner had not filed his answer in time. See also *Greengard* v. *Commissioner*, 29 F. (2d) 502 (C. C. A. 7th). In *Hanby* v. *Commissioner*, 67 F. (2d) 125 (C. C. A. 4th), it was held that a question of fraud was properly put in issue although not affirmatively alleged in the Commissioner's answer where it was obvious to petitioner that fraudulent conduct on his part formed the basis of the Commissioner's determination. These decisions indicate that the Board, an administrative body, is not bound by strict rules of pleading and that the Circuit Court of Appeals had authority to consider the estoppel issue. Both the Board and the Circuit Court of Appeals considered the question of estoppel in the *Crane* case, though the issue was not raised in the pleadings.

APPENDIX

REVENUE ACT OF 1928, C. 852, 45 STAT. 791

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

* * * * *

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Property acquired after February 28, 1913.*—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * *

REVENUE ACT OF 1921, C. 136, 42 STAT. 227

SEC. 213. That for the purposes of this title (except as otherwise provided in section 233) the term "gross income"—

(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain

or profit, or gains or profits and income derived from any source whatever. The amount of all such items (except as provided in subdivision (e) of section 201) shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period; * * *

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